California Student Aid Commission's
Administration of the Federal Family Education Loan Program
Federal and Operating Funds

FINAL AUDIT REPORT

ED-OIG/A09-C0013
March 2003

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U.S. Department of Education
Office of Inspector General
Sacramento, California

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

501 I Street, Room 9-200
Sacramento, California 95814
Central Office Number: (916) 930-2388
FAX Number: (916) 930-2390

March 27, 2003

MEMORANDUM

TO: Ms. Theresa S. Shaw
Chief Operating Officer
Federal Student Aid

FROM: Gloria Pilotti *Gloria Pilotti*
Regional Inspector General for Audit

SUBJECT: FINAL AUDIT REPORT
California Student Aid Commission's Administration of the Federal Family Education Loan Program Federal and Operating Fund
ED-OIG/A09-C0013

Attached is our subject report presenting our findings and recommendations resulting from our audit of the California Student Aid Commission.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for the resolution of the findings and recommendations in this report.

If you have any questions, please contact me at (916) 930-2399.

Please refer to the above control number in all correspondence relating to this report.

Attachment

Electronic cc: Kristie Hansen, Financial Partners Channel, FSA
Ralph Arosemena, Audit Liaison Officer, FSA

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The California Student Aid Commission (CSAC) did not fully comply with the Higher Education Act of 1965 (HEA), as amended, and applicable Federal regulations in its establishment of the Federal and Operating Funds and its subsequent administration of the Federal Fund for the Federal Family Education Loan (FFEL) program. We concluded that CSAC—

- Improperly used its reserve funds for $7.4 million of accrued administrative expenses. Federal regulations required that expenses be deducted from the reserve fund upon their payment, without any accrual for accounting purposes. Since the administrative expenses had not been paid from reserve funds by September 30, 1998, CSAC should have classified the amounts as expenses of the Operating Fund.

- Improperly used $4.5 million of reserve funds for September 1998 purchases that were used to administer the FFEL program after September 30, 1998. The HEA and Federal regulations state that such costs are costs of the Operating Fund. We also concluded that EDFUND did not use sound business practices when making the purchases.

- Improperly used about $1 million of the Federal Fund for the cost of supplemental preclaims assistance activities. Under the HEA and Federal regulations, supplemental preclaims assistance costs are not an authorized use of the Federal Fund.

- Delayed deposits of Federal payments into the Federal Fund. As a result, the Federal Fund did not realize interest earnings of about $264,000 while the Federal payments were in bank accounts held by CSAC and its auxiliary organization, EDFUND. The HEA and Federal regulations require guaranty agencies to invest funds transferred to the Federal Fund and exercise the level of care required of a fiduciary charged with the duty of investing the money of others.

- Did not deposit fees in the Federal Fund for the net fair value of its use of Federal assets. Federal regulations require that the usage fees be paid to the Federal Fund not less frequently than quarterly. The Financial Partners Channel of the U.S. Department of Education, Federal Student Aid (FSA), [1] previously reported this finding.

We recommended that the Chief Operating Officer for Federal Student Aid require CSAC to reimburse the Federal Fund for the above amounts plus related interest and take corrective action to ensure that the Federal payments are deposited in the Federal Fund within one business day and usage fees are paid to the Federal Fund at least quarterly.

The OTHER MATTERS section of the report provides information on other areas that came to our attention during the review concerning (1) untimely transfer of reserve funds to the Federal Fund, (2) delayed deposit of interest earned on the Federal share of collections into the Federal Fund and (3) use of the collection account for purposes other than collections on defaulted loans.

[1] Prior to March 6, 2002, FSA was known as Student Financial Assistance.

In its comments to the draft report, CSAC stated that new procedures were implemented to ensure Federal payments are deposited into the Federal Fund within one day of receipt and that a cash transfer was made to the Federal Fund for the lost interest. CSAC did not agree with our other findings and recommendations. CSAC's comments to the draft report are summarized at the end of each finding and included in their entirety as Attachment 2.

AUDIT RESULTS

The objective of the audit was to determine whether CSAC complied with the HEA and Federal regulations governing the establishment and operations of the Federal and Operating Funds. Specifically, we evaluated the (1) initial establishment of the two funds, (2) sources and uses of the funds, and (3) ownership of nonliquid assets and usage fees paid. We concluded that CSAC did not fully comply with the applicable HEA provisions and Federal regulations when it established the Federal and Operating Funds. Also, CSAC did not fully comply with the HEA provisions and Federal regulations pertinent to the sources and uses of the funds and the payment of usage fees to the Federal Fund except CSAC did properly identify the ownership of fixed assets.

FINDING NO. 1 – CSAC Improperly Used Its Reserve Funds for $7.4 Million of Accrued Administrative Expenses

When determining the reserve fund balance on September 30, 1998, CSAC reduced the balance by $7.4 million for EDFUND and other FFEL-related administrative expenses that were accrued, but not yet paid from reserve funds. Federal regulations required that expenses be deducted from the reserve fund upon their payment, without any accrual for accounting purposes. Since these administrative expenses had not been paid from reserve funds by September 30, 1998, CSAC should not have included the amounts in determining the reserve fund balance and should have classified the amounts as expenses of the Operating Fund.

FFEL Program Administrative Expenses Not Paid From Reserve Funds By September 30, 1998 Must Be Classified As Expenses of the Operating Fund

The Higher Education Amendments of 1998, enacted on October 7, 1998, required each guaranty agency to establish a Federal Fund and an Operating Fund and deposit all funds, securities, and other liquid assets contained in its reserve fund into the Federal Fund. In its Dear Guaranty Agency Letter 99-G-316, dated January 27, 1999, the Department's Financial Partners Channel reiterated the requirement—

> The Secretary has decided that all of the funds, securities, and other liquid assets in the agency's reserve fund as of September 30, 1998, as described in 34 CFR 682.410(a) , must be deposited into the Federal Fund when it is established.

The regulation at 34 C.F.R. § 682.410(a)(3)[2] specifies the accounting basis to be used for the reserve fund.

[2] All regulatory citations are to the Code of Federal Regulations revised as of July 1, 2000.

> *Accounting basis*. Except as approved by the Secretary, a guaranty agency . . . shall deduct the items listed in paragraph (a)(2) of this section from its reserve fund upon their payment, without any accrual for accounting purposes.

Thus, only expenses paid from reserve funds prior to October 1, 1998, may be considered expenses of the reserve fund. All other expenses must be assigned to either the guaranty agency's Federal Fund or Operating Fund.

As amended, HEA § 422A(d) limits the uses of Federal Fund assets.

> [T]he Federal Fund may only be used by a guaranty agency—
> (1) to pay lender claims . . . ; and
> (2) to pay into the Agency Operating Fund . . . a default aversion fee . . . .

HEA § 422B(d)(1) states that guaranty agencies must use the Operating Fund for other costs of administering the FFEL program.

> Funds in the Operating Fund shall be used for application processing, loan disbursement, enrollment and repayment status management, default aversion activities . . . default collection activities, school and lender training, financial aid awareness and related outreach activities, compliance monitoring, and other student financial aid related activities, as selected by the guaranty agency.

FFEL program costs not listed in the HEA § 422A(d) and paid after September 30, 1998, must be classified as expenses of the Operating Fund.

CSAC Used the Reserve Fund After September 30, 1998 for FFEL Program Operating Expenses

To determine its reserve fund balance as of September 30, 1998, CSAC combined amounts derived from the financial records of CSAC and EDFUND.[3] Since CSAC used a modified accrual accounting basis and EDFUND used an accrual accounting basis for its records, the combined amounts included accrued revenue and accrued expenses. Accrued revenue represented revenue earned, but not yet received. Accrued expenses represented expenses incurred, but not yet paid.

Our review of the payable and accrued[4] amounts identified the following amounts paid from the reserve fund after September 30, 1998, which should have been classified as costs of the Operating Fund:

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[3] At this time, EDFUND only held amounts provided from CSAC's reserve funds. When EDFUND was created, CSAC provided EDFUND with an initial advance of $20 million from the reserve funds. Each month, EDFUND submitted invoices to CSAC for all incurred expenses. CSAC used state warrants issued from the reserve funds to pay the EDFUND invoices.

[4] Vacation accrual represents earned but unused vacation pay. Retirement insurance accrual is a recorded liability for EDFUND's retirement plan for certain direct hire employees. Salary and other accruals represent estimates of expenses that have been incurred but not yet paid.

CSAC collection agency fees payable	$3,433,637
EDFUND vacation accruals	1,214,770
EDFUND retirement insurance accrual	800,116
EDFUND salary accruals	603,319
EDFUND vendor and payroll accounts payable	253,418
Other CSAC payables	267,919
Other EDFUND accruals	874,484
Total	$7,447,663

By including these accrued expenses in determining the reserve fund balance on September 30, 1998, CSAC understated the reserve fund balance by $7,447,663, and as a result, the amount transferred to the Federal Fund was understated by the same amount. We concluded that the accrued revenues and other accrued expenses that CSAC included in determining the reserve fund balance did not impact the current balance in the Federal Fund since the related revenues and expenses would have been appropriate sources and uses of the Federal Fund after September 30, 1998.[5]

Recommendation

1.1 We recommend that the Chief Operating Officer for Federal Student Aid require CSAC to return the $7,447,663 to the Federal Fund plus $1,533,597[6] of imputed interest from October 1, 1998 through December 31, 2002. Also, return the interest earned on the $7,447,663 from January 1, 2003, through the date it was transferred to the Federal Fund.

CSAC Comments

In its response to the draft report, CSAC stated that it was acting under specific and appropriate guidance from the Department in its use of accrual accounting and requested that the finding be removed from the report. CSAC stated that the Department instructed guaranty agencies during an August 1998 training conference that the reserve fund balance reported on the Form 1130 (currently called Form 2000) should equal the amounts on the guaranty agency's general ledger on an accrual basis. CSAC noted that 34 C.F.R. 682.410(a)(3) allowed the Secretary to approve a different basis other than cash and concluded that the Department specifically approved a different accounting basis by explicitly directing guaranty agencies to use accrual accounting for the period ending September 30, 1998.

CSAC stated that 34 C.F.R. 682.419(f)(1) instructed the guaranty agencies to use the accrual basis of accounting for the Federal and Operating Funds required by the HEA Amendments of 1998. CSAC concluded that "[b]ecause the reauthorization act [HEA Amendments of 1998] implemented accrual accounting as the official accounting basis, it was clearly logical that the September 30, 1998 year-end report be on this same basis." CSAC also stated "if CSAC failed to utilize this consistent method of accounting, a reconciliation tracing the transition from a one

[5] The accrued revenues were for interest receivable on reserve funds and amounts due from the Federal government for defaulted loan purchases, reinsurance, supplemental preclaims assistance, and administrative expense allowance. The other accrued expenses were amounts due to the Federal government for lender claims, Federal share of collections, and loan repurchases.

[6] All imputed interest amounts in the report were calculated using the California State Controller's Surplus Money Investment Fund Apportionment Yield Rate. We used the period ending June 30, 2002 rate through December 31, 2002 because the December 31, 2002 rate was not yet posted.

fund to a two fund structure would be virtually impossible." Lastly, CSAC noted that generally accepted accounting principles approve the use of accrual accounting since it more accurately matches revenues and expensese to the accounting period.

OIG Response

Our finding and recommendation remain unchanged. CSAC was required to establish the Federal Fund in accordance with the HEA and applicable regulations. The HEA required each guaranty agency to deposit "all funds, securities, and other liquid assets" of its reserve fund into the Federal Fund, and the cited regulation specified that deductions from the reserve fund will be made without accrual for accounting purposes. The Department's January 1998 edition of the published instructions for the Form 1130 were consistent with the HEA and regulations. The instructions, which had an expiration date of September 30, 1998, stated—

> The amounts reported . . . must be on a cash basis for, or through, the end of the Federal fiscal year, September 30, as required in each item. This must be done regardless of the agency's method and period of accounting used for its annual audited financial statement and other financial reports.

CSAC provided no documentation from the August 1998 training conference indicating that the Department modified its published instructions for the Form 1130 covering the period ended September 30, 1998.

The accounting basis required for the Federal Fund is not relevant since the regulations specified the accounting basis for the predecessor reserve funds and the HEA required transfer of all liquid assets. Also, CSAC's statement that a consistent accounting method was needed to reconcile reserve fund transfers to the Federal and Operating Funds does not have merit. As we reported in the AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY section, we used an alternative methológody to confirm that the reserve fund assets were transferred since we were unable to identify from CSAC records the transfers to the Federal Fund that comprised the reserve fund assets at September 30, 1998.

The fact that generally accepted accounting principles require the use of accrual accounting for financial statement reporting purposes is not relevant. CSAC was required to adhere to the HEA and applicable regulations when transferring reserve fund assets to the Federal Fund.

FINDING NO. 2 – CSAC Improperly Used Its Reserve Funds for $4.5 Million of Purchases That Were Used for Administering the FFEL Program After September 30, 1998

CSAC used reserve fund assets to pay EDFUND for about $5.1 million of equipment, software, and equipment-related services purchased in September 1998.[7] Our review of three EDFUND purchase agreements, which accounted for $4.5 million of the $5.1 million in purchases, found that the purchased equipment, software, and services were for administration of the

[7] Typically, monthly purchases for equipment and other fixed assets were significantly less: $50,847 in August 1998, $22,383 in October 1998, and $50,970 in November 1998.

FFEL program after September 30, 1998. Thus, the costs were not a necessary use of the reserve fund assets. We also concluded that EDFUND did not use sound business practices when making the purchases. Based on actions taken, which we describe in this finding, we concluded that EDFUND timed the execution of the purchases in order to issue checks to vendors before September 30, 1998. After that date, payments for such purchases would be made from the Operating Fund. Given the timing of the purchases and the fact that the purchased equipment, software, and services were for administering the FFEL program after September 30, 1998, CSAC should have identified the $4.5 million as costs of the Operating Fund.

Guaranty Agencies Must Ensure That Costs Are Necessary and Reasonable

Federal regulations required that guaranty agencies use reserve fund assets for necessary and reasonable costs. The regulations at 34 C.F.R. § 682.410(a)(2) state—

> [a] guaranty agency . . . shall use the assets of the reserve fund to pay only . . . [c]osts that are reasonable, as defined under § 682.410(a)(11)(iii) , and that are ordinary and necessary for the agency to fulfill its responsibilities under the HEA . . . Those costs must be . . . [n]et of all applicable credits.

The regulations at 34 C.F.R. § 682.410(a)(11)(iii) define the term "reasonable costs" and state that the guaranty agency has fiduciary responsibility for establishing that costs are reasonable, including that the agency used prudent business practices.

> *Reasonable cost* means a cost that, in its nature and amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. **The burden of proof is upon the guaranty agency, as a fiduciary under its agreements with the Secretary, to establish that costs are reasonable.** In determining reasonableness of a given cost, consideration must be given to—
>
> (A) Whether the cost is of a type generally recognized as ordinary and necessary for the proper and efficient performance and administration of the guaranty agency's responsibilities under the HEA;
>
> (B) The restraints or requirements imposed by factors such as **sound business practices**, arms-length bargaining, Federal, State, and other laws and regulations, and the terms and conditions of the guaranty agency's agreements with the Secretary; and
>
> (C) Market prices of comparable goods or services.
>
> [emphasis added.]

EDFUND's Purchases Were Not Needed or Used to Administer the FFEL Program Before October 1, 1998

The three purchase agreements covered equipment, software, and services related to EDFUND's Financial Aid Solutions and Technology (FAST) project. The primary purpose of the FAST project was to migrate the CSAC's Student Loan Portfolio and EDFUND's Business Support system from Financial Aid Processing System (FAPS) to an augmented version of a system owned by the Great Lakes Higher Education Guaranty Corporation (Great Lakes). The FAST project included revamping EDFUND's servers, processors, and printers to accommodate the new system.[8] The FAST project was scheduled to be completed over a 24-month period. EDFUND reported the following project accomplishments as of September 30, 1998: EDFUND signed a contract with Great Lakes and developed the project organization structure, project schedule, requirements definition, and implementation business plans.

As shown in the table below, the vendors delivered the equipment for the FAST project just one day before September 30, 1998, and for two purchases the equipment was delivered to a warehouse because EDFUND facilities were not yet ready to receive the equipment. Also, except for a few days, the service periods specified in the contracts were for periods after September 30, 1998. For example, purchase agreement E-97-114 included the cost of 20 million printing impressions for printers delivered to EDFUND facilities on September 29, 1998.

		Date			**Service Period Covered By Agreement**
E-97-107	Server, software, maintenance services, training and certification of EDFUND personnel, and installation and configuration services (Cost $3,268,222)	8/21/98	9/3/98	9/29/98 to warehouse (b)	9/4/98 to 9/3/99
E-97-110	Two servers, software, maintenance services, training, and installation and configuration services (Cost $334,710)	(a)	9/21/98	9/30/98 to warehouse (b)	9/29/98 to 12/31/98
E-97-114	Two printers with servers, consulting services, maintenance services, and 20 million impressions (Cost $918,979)	9/25/98	9/29/98	9/29/98 to EDFUND facility	9/29/98 to 9/30/99

(a) The EDFUND Request for Contract Services was dated 9/18/98. EDFUND internal memorandum dated 9/24/98, states that three vendor quotes were compared, but EDFUND-provided documentation did not show when the quotes were solicited or received. Based on our review of provided documents, we concluded that the purchase agreement may have been signed prior to obtaining the vendor quotes.

(b) Shipped/delivered to warehouse space leased by vendor in accordance with terms specified in the agreement.

By including the cost of purchases used to administer the FFEL program after September 30, 1998 in determining the reserve fund balance, CSAC understated the reserve fund balance by $4,521,911. As a result, the amount transferred to the Federal Fund was understated by the same amount. Attachment 1 of this report contains a list of an additional $571,809 of EDFUND purchases made and paid with reserve funds during September 1998, which CSAC also included in determining the reserve fund balance.

[8] EDFUND and Great Lakes signed a Memorandum of Understanding and Master Development Agreement on January 12, 1998 establishing the terms of their relationship. This agreement was superseded by a contract, effective September 23, 1998. Subsequently, EDFUND halted the FAST project and terminated its agreement with Great Lakes.

EDFUND Did Not Use Sound Business Practices When Making the Purchases

We concluded that EDFUND complied with its own purchasing procedures, but that CSAC did not meet its fiduciary responsibility to ensure that costs are reasonable, including that EDFUND used prudent business practices. Our review of the three purchase orders found that EDFUND:

- Purchased and accepted delivery of equipment for the FAST project prior to having its facility ready for installation of the equipment. Also, there did not appear to be an urgent need for the purchases since EDFUND had only completed the contract and planning as of September 30, 1998.
- Included unnecessary rush delivery conditions and warehouse storage in its request for bids. The three bid requests specified delivery of the products by September 30, 1998, and two contracts included the agreement for insured warehouse storage until EDFUND's facility was ready for installation of the equipment. The equipment received under purchase agreement E-97-107 was installed at EDFUND's facility in February 1999, about five months after the vendor delivered the equipment to the leased warehouse space. The equipment received under purchase agreement E-97-110 was delivered to EDFUND's facility on October 28, 1998, about one month after its receipt at the warehouse.
- Established limited time frames for vendors to submit bids. For example, an urgent request for bids for the equipment that was purchased under agreement number E-97-114 was sent to selected vendors on September 25, 1998 with firm bids due by 5:00 PM of the same day.
- Expedited payments to vendors, but did not take advantage of offered cash discounts. EDFUND issued checks to vendors on September 30, 1998 for the three purchases. The vendor for two purchases offered 0.5% discounts if the invoice was paid within five days from the invoice date. EDFUND paid one invoice within the 5-day period, but did not reduce the amount by the $1,562 offered discount. For the other invoice, which offered a discount of $15,122, EDFUND paid the invoice one day after the discount period.
- Had no plans at the end of June 1998 to purchase the $4.5 million of equipment, software and equipment-related services before October 1, 1998. While the CSAC-approved budget for the period October 1, 1997 through September 30, 1998 included about $11.4 million for the FAST project, EDFUND's budget forecast, as of June 30, 1998, projected that about $1.8 million would be expended on the FAST project for the year.

From the above actions, we concluded that EDFUND timed the execution of the purchase agreements, deliveries, and payments for the purchased equipment and services in order to use reserve fund assets for the purchases rather than to ensure that EDFUND obtained necessary equipment when needed and at the best price.

In fact, the equipment purchased under the three purchase agreements actually exceeded EDFUND's needs because the FAST project was eventually discontinued. In a letter to the Department, dated December 12, 2000, CSAC stated, "In the cases of the server and printers, [CSAC] did not utilize the equipment for the intended purpose, which was converting to an in-house loan processing system, making the equipment worth less to the organization than the book value states. Given the current uses of the equipment, CSAC/ EDFUND would be able to run the system just as efficiently with a server costing a fraction of the book value."

Recommendations

We recommend that the Chief Operating Officer for Federal Student Aid require CSAC to—

2.1 Return $4,521,911 to the Federal Fund for the cost of the three purchase agreements plus $931,137 of imputed interest from October 1, 1998 through December 31, 2002. Also, return the interest earned on the $4,521,911 from January 1, 2003, through the date it was transferred to the Federal Fund.

2.2 Return $571,809[9] and the related imputed interest to the Federal Fund for the other equipment purchases made in September 1998, or submit documentation to FSA showing that the purchases were necessary for administering the FFEL program prior to October 1, 1998 and that sound business practices were used in making the purchases.

CSAC Comments

CSAC requested that the finding be removed from the report. CSAC stated "[w]hile the OIG may disagree with the business decision that was made [to purchase the equipment and services in September 1998], that is not a sufficient basis for disallowing the expenditures." CSAC stated that the procurement process began well before September 1998 and that the purchases were consistent with standard business practices and accounting standards as reviewed by its independent accounting firm. CSAC stated "in the period immediately preceding and then in September 1998, CSAC was functioning with the best information available at the time on a project that had an aggressive completion time line and one that was fully authorized and approved."

OIG Response

Our finding and recommendations remain unchanged. CSAC's comments did not fully address our basis for disallowing the expenditures. Our primary basis for recommending that the Federal Fund be reimbursed for the three EDFUND purchases was that the purchased equipment, software, and services were for administration of the FFEL program after September 30, 1998, and as such the purchases were not a necessary use of reserve funds. CSAC should have identified the purchases as costs of the Operating Fund.

We acknowledged in the finding that EDFUND complied with its own purchasing procedures. However, from its actions, we concluded that EDFUND timed the execution of the purchase agreements, deliveries, and payments for the purchased equipment and service in order to use reserve fund assets for the purchases rather than to ensure the EDFUND obtained necessary equipment when needed and at the best price.

[9] The amount to be returned to the Federal Fund may be higher than the $571,809 identified from CSAC's fixed asset list since that amount may not include maintenance, training, and other service costs, which may have also been paid with reserve funds.

FINDING NO. 3 – CSAC Improperly Used About $1 Million of the Federal Fund for Supplemental Preclaims Assistance Activities

CSAC used $1,016,489 from the Federal Fund to pay costs of supplemental preclaims assistance (SPA) activities.[10] The HEA § 422A(d) and the regulations at 34 C.F.R. § 682.419(c) , which are cited in Finding No. 1, do not list SPA costs as an authorized use of the Federal Fund.

CSAC improperly concluded that the Federal Fund could be used for the cost of SPA activities since the HEA Amendments of 1998 required guaranty agencies to deposit Federal payments for SPA activities in the Federal Fund. SPA was collection assistance provided to lenders by guaranty agencies or their contractors that was designed to encourage borrowers to begin or resume payment of their loans. Prior to the enactment of the Higher Education Amendments of 1998, the Federal Government paid guaranty agencies $50 for each borrower account that was subject to preclaims assistance and not submitted later as a default claim by the lender. While the HEA § 422A(c)(4) required guaranty agencies to deposit into the Federal Fund any Federal payments for SPA activities performed prior to the enactment of the HEA Amendments, the HEA did not authorize the use of the Federal Fund for the related collection assistance costs that were not paid from the reserve fund by September 30, 1998. Also, the Secretary had not authorized the use of the Federal Fund for this purpose.

Recommendation

3.1 We recommend that the Chief Operating Officer for Federal Student Aid require CSAC to return $1,016,489 to the Federal Fund plus $172,225 of imputed interest through December 31, 2002. Also, return the interest earned on the $1,016,489 from January 1, 2003 through the date it was transferred to the Federal Fund.

CSAC Comments

CSAC requested that the finding be removed from the report. CSAC believed that the Department's intent was to consider preclaims assistance costs on borrower accounts that were assigned to contractors for SPA activities prior to October 1, 1998, as an acceptable use of the Federal Fund. CSAC stated that the Department previously recognized the appropriateness of matching SPA revenue with related expenses in the regulation at 34 C.F.R. § 682.410. CSAC also referred to a "Question and Answer" document that advised guaranty agencies to use the Federal Fund for such preclaims assistance costs. CSAC stated that the document was provided to the Department for review and the Department's failure to reply was interpreted as implied consent to all items discussed in the document. In addition, CSAC noted that the matching of revenues and expenses is in accordance generally accepted accounting principles.

Lastly, CSAC stated that it could have recorded the accrued SPA revenue and preclaims assistance expenses in the reserve fund on September 30, 1998, which would have the same impact on the Federal Fund as the actions taken, i.e. paying the preclaims assistance expenses from the Federal Fund.

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[10] CSAC did not include the $1,016,489 as an accrued expense when it determined the reserve fund balance as of September 30, 1998.

OIG Response

Our finding and recommendation remain unchanged. The HEA and regulations do not list preclaims assistance costs as an authorized use of the Federal Fund. The regulations cited in CSAC's comments contain no reference to matching SPA revenues with related expenses. According to the transmittal letter provided with the "Question and Answer" document, the document reflects the efforts of representatives from the Consumer Bankers Association, the Education Finance Council, the National Council of Higher Education Loan Programs, the Student Loan Servicing Alliance and Sallie Mae. The fact that the Department did not respond to this document does not mean the Department has given implied consent to items presented in the document. As we mention previously, generally accepted accounting principles for financial statement reporting purposes are not relevant. CSAC must adhere to the HEA and applicable regulations when using assets of the Federal Fund.

FINDING NO. 4 – CSAC's Procedures Delayed Deposits of Federal Payments Into the Federal Fund

CSAC did not deposit Federal payments directly into the Federal Fund. CSAC received Federal payments for reinsurance claims, administrative cost allowance, and supplemental preclaims assistance by electronic fund transfer (EFT), which were initially deposited in an EDFUND bank account. Under its current procedures, EDFUND issues a check to CSAC for the EFT amount. CSAC deposits the EDFUND check in a State bank account and then transfers the EFT amount to the Federal Fund.[11]

The HEA § 422A (b) requires that "[f]unds transferred to the Federal Fund shall be invested in obligations issued or guaranteed by the United States or a State, or in other similarly low-risk securities…." The HEA § 422A (c) lists the amounts that must be deposited into the Federal Fund, which includes Federal payments received from the Secretary for reinsurance claims, administrative cost allowance, and supplemental preclaims assistance:

> After the establishment of the Federal Fund, a guaranty agency shall deposit into the Federal Fund—
>
> 1. All amounts received from the Secretary as payment of reinsurance on loans…
>
> 4. All amounts received from the Secretary as payment for supplemental preclaims activity performed prior to the date of enactment of this section;
>
> 5. 70 percent of amounts received after such date of enactment from the Secretary as payment for administrative cost allowance for loans upon which insurance was issued prior to such date of enactment….

[11] During the period December 1998 through November 1999, CSAC deposited the EDFUND check in its bank account, transferred the EFT amount from its bank account to the Operating Fund, and then transferred the reinsurance amount from the Operating Fund to the Federal Fund.

Under the requirements for administering the Federal Fund, in 34 C.F.R. § 682.419(a),"…The guaranty agency must exercise the level of care required of a fiduciary charged with the duty of protecting, investing, and administering the money of others."

CSAC's procedures delayed deposits of Federal payment into the Federal Fund. From December 1998 through November 1999, transfers to the Federal Fund were an average of six days after the EFT date for the reinsurance claims and administrative cost allowance and an average of 36 days for the supplemental preclaims assistance. After November 1999, CSAC no longer transferred EFT payments to the Operating Fund before transferring amounts to the Federal Fund. While the revised procedures decreased the delays, the transfers to the Federal Fund from December 1999 through September 2002 were still an average of two days after the EFT date.

The Federal Fund did not realize interest earnings while the Federal payments were held in the EDFUND and CSAC bank accounts. We calculated that the Federal Fund would have earned an additional $264,141 in interest earnings during the period from December 1998 through September 2002, if EFT amounts had been promptly deposited into the Federal Fund.[12]

Recommendations

We recommend that the Chief Operating Officer for Federal Student Aid require CSAC to—

4.1 Implement procedures that ensure that EFT payments are deposited into the Federal Fund within one business day of their receipt.

4.2 Reimburse the Federal Fund for the $264,141 of interest earnings lost during the period December 1998 through September 2002 and any additional earnings lost subsequent to that period.

CSAC Comments

CSAC concurred with the finding and recommendations. CSAC stated that new procedures were implemented in September 2002, to ensure deposits to the Federal Fund are processed within one business day of receipt. CSAC also stated that $264,141 was transferred to the Federal Fund on January 13, 2003, for lost interest earnings.

[12] For the period from December 1998 through November 1999, we allowed two business days from the EFT date for the funds to be deposited in the Federal Fund. During this period, CSAC needed to identify the EFT amount allocable to the Federal Fund and the Operating Fund. From December 1999 to September 2002, we allowed one business day since the EFTs only included amounts to be deposited in the Federal Fund.

FINDING NO. 5 – CSAC Did Not Pay Usage Fees to the Federal Fund

CSAC and EDFUND used nonliquid assets purchased with Federal reserve funds in the performance of the guaranty agency's activities. CSAC did not deposit in the Federal Fund the net fair value of its use of the assets (usage fees). This finding was previously reported by FSA's Financial Partners Channel in a program review report, dated October 22, 2001.

The regulations at 34 C.F.R. §682.420 (c)(1)(i), which became effective on July 1, 2000, require guaranty agencies to deposit such usage fees in the Federal Fund.

> If a guaranty agency uses the Federal portion of a nonliquid asset in the performance of its guaranty activities (other than an intangible or intellectual property asset or a tangible asset of nominal value), the agency must promptly deposit into the Federal Fund an amount representing the net fair value of the use of the asset.

The regulations at 34 C.F.R. §682.420 (c)(2) require that the usage fees be paid to the Federal Fund not less frequently than quarterly.

Instead of paying usage fees, CSAC proposed buying the Federal assets. In a letter to FSA's Financial Partners Channel, dated December 12, 2000, CSAC proposed to buy all Federal assets with an original purchase cost of $50,000 or more. CSAC concluded that "any item purchased for less than $50,000 would have experienced substantial depreciation and therefore would currently be valued at only a nominal amount."[13] CSAC identified 16 Federal assets with a purchase cost of $50,000 or more. CSAC offered $113,500 (one-tenth of the $1,135,000 book value) to buy the 16 Federal assets, which had a combined original purchase cost of $6,262,610.[14]

In its program review report, Financial Partners Channel informed CSAC that, until the purchase of assets is transacted, usage fees must be paid beginning with the quarter ending September 30, 2000, and instructed CSAC to provide documentation showing the methods used to calculate the usage fee. In its response to the program review report, CSAC informed Financial Partners Channel that it had made a "good faith offer for the purchase of the non-liquid assets" and deposited $113,500 in an interest bearing account pending FSA's consideration of CSAC's offer.

[13] CSAC's audited financial statements for the period ending June 30, 2000 reported equipment and software with a purchase cost of $8,212,736. Of this amount, CSAC identified equipment with purchase costs of $50,000 or more totalling $6,262,610. The remaining $1,950,126 included 19 vehicles purchased in August 1997 for about $18,000 each, and 7 vehicles purchased between May and July 1998 for amounts ranging from about $18,000 to $38,500.

[14] In its letter, CSAC noted that four technology-based items (a voice response system, two printers, and a server) accounted for $5,266,951 of the $6,262,610 original purchase cost and that since these items "rely on the use of technology that has since been significantly updated and improved, the resale value represents only a small fraction of the current book value."

The CSAC offer to purchase the assets does not release CSAC from the obligation to pay usage fees. Until CSAC and the Financial Partners Channel conclude the sale of the assets, CSAC is required by the regulations to pay usage fees to the Federal Fund.

Recommendations

We recommend that the Chief Operating Officer for Federal Student Aid require CSAC to—

5.1 Deposit in the Federal Fund an amount representing the net fair value of the use of the assets for the period from July 1, 2000 to current, including related interest for the late payment. (Excluding the purchases questioned in Finding No. 2, CSAC records show that the Federal nonliquid assets had an original purchase cost collectively of $2,927,949).

5.2 Implement procedures that ensure usage fees are paid to the Federal Fund at least quarterly.

CSAC Comments

CSAC stated that it has not yet received a response from the Department concerning its offer. CSAC stated that it continues to hold the offered funds for the purchase of the assets in an interest-bearing account pending the outcome of discussions between CSAC and the Department.

OIG Response

Our recommendations remain unchanged. The regulations require that CSAC pay usage fees to the Federal Fund starting July 1, 2000.

OTHER MATTERS

Transfer of Funds to Federal Fund Was Not Completed Timely. The HEA § 422 required that each guaranty agency, within 60 days of enactment of the HEA Amendments of 1998, establish a Federal Fund and deposit all of the funds, securities, and other liquid assets of its reserve fund into the Federal Fund. The deadline for this action was December 6, 1998. CSAC did not transfer all funds from the reserve fund into the Federal Fund when it established the Federal Fund on December 2, 1998. The transfers were made from December 1998 to June 1999. The original reserve fund was eventually closed on June 23, 1999.

Also, CSAC continued to record accounting transactions in the reserve fund after establishment of the Federal and Operating Funds. Thus, transfers from the reserve fund to the Federal Fund included the revenues and expenditures prior to and after October 1, 1998. As discussed in the AUDIT OBJECTIVE, SCOPE, AND METHODOLGY section of the report, we were unable to identify the individual transfers to the Federal Fund that comprised the reserve fund balance as of September 30, 1998. That section describes the alternative approach that we used to confirm that the reserve fund assets determined by CSAC were transferred to the Federal Fund. This alternative approach provide us with an acceptable level of assurance that reserve fund assets, except for those funds identified in the AUDIT RESULTS section, were transferred to the Federal Fund.

Investment Earnings on the Federal Share of Collections Not Deposited in Federal Fund Timely. The regulations at 34 C.F.R. §682.419(b)(6) state that a guaranty agency is required to deposit into its Federal Fund all funds received on loans (loan collections) for which a lender claim has been paid within 48 hours of receipt of those funds, minus any portion that the agency is authorized to deposit into the Operating Fund. In its program review report, dated October 22, 2001, FSA's Financial Partners Channel reported that CSAC had calculated, but not transferred to the Federal Fund, the interest earnings on the Federal share of loan collections received from October 1998 through August 2000. On August 9, 2002, FSA signed a settlement agreement with the guaranty agencies that divided the investment earnings between the Federal Fund and Operating Fund. On September 6, 2002, CSAC deposited $618,693 into the Federal Fund, which based on CSAC's calculations, represented the appropriate interest earnings.

Collections Account Not Used Solely for Collections. Dear Guaranty Agency Director letter G-00-328 issued July 2000, provided guaranty agencies with an option to deposit the Federal share of collections into a separate agency-controlled account. The letter stipulated that the "account may only be used to hold collections and disburse the proper shares to the Federal Fund and Operating [F]und." CSAC selected this option and used an EDFUND account to hold collections. However, EDFUND also used the account for electronic fund transfers from the Department for loan processing issuance fees, account maintenance fees, and 1189 Form reimbursements for reinsurance claims. In addition, EDFUND held $1,186,585 of accrued interest on the Federal share of loan collections received from October 1998 through August 2000 and the $113,500 "good faith" offer for the purchase of the nonliquid assets in the account. While EDFUND maintained records identifying the balances and interest earnings allocable to the various amounts, CSAC should follow the guidance in the Dear Guaranty Agency Director letter and instruct EDFUND to use the account solely for collections.

BACKGROUND

The Higher Education Amendments of 1998, enacted on October 7, 1998, required each guaranty agency to establish a Federal Fund and an Operating Fund. The final date for establishing these funds was December 6, 1998. The guaranty agencies were to transfer all funds, securities and other liquid assets of the guaranty agency's FFEL program reserve fund to the Federal Fund, which is the property of the Federal Government. The HEA required guaranty agencies to deposit revenue from specific sources into the Federal Fund and defined the uses of Federal Fund assets. The HEA as amended, also specified the deposits to be made into the Operating Fund and the general uses of Operating Fund assets. Except for funds transferred from the Federal Fund, the Operating Fund is the property of the guaranty agency. If the Operating Fund contains funds transferred from the Federal Fund, the Operating Fund assets may be used only as permitted by the regulations.

The California State Legislature created the CSAC in 1955. CSAC is the state agency responsible for administering financial aid programs including FFEL program, the state-funded CAL-Grant program, and other state-funded postsecondary education programs for students attending public and private universities, colleges, and vocational schools in California. On January 2, 1997, CSAC founded EDFUND, a non-profit corporation, as its auxiliary organization to provide operational and administrative services relating to the FFEL program. The main offices for CSAC and EDFUND are located in Rancho Cordova, California.

AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine whether CSAC complied with the HEA and Federal regulations governing the establishment and operations of the Federal and Operating Funds. Specifically, we evaluated the (1) initial establishment of the two funds, (2) sources and uses of the funds, and (3) ownership of nonliquid assets and usage fees paid.

We gained an understanding of the applicable HEA provisions and Federal regulations, various State reports, and relevant CSAC and EDFUND procedures. We reviewed relevant FSA Dear Colleague Letters, FSA Dear Guaranty Agency Director Letters, and correspondence between CSAC and FSA. We reviewed CSAC's audited financial statements prepared by its independent public accountant and findings reported in the California statewide single audit reports for the periods July 1, 1997 through June 30, 2000 prepared by the California Bureau of State Audits. We interviewed the auditors from the California Bureau of State Audits who performed the California statewide single audit for the year ended June 30, 1999. We also contacted the independent public accountant that conducted the CSAC's financial statement audit for the year ended June 30, 1999. We reviewed FSA's Financial Partners Channel report, dated October 22, 2001, on its program review of CSAC conducted during June 11-15, 2001 and report, dated August 14, 1998 conducted during January 26 through February 6, 1998. We interviewed various CSAC and EDFUND personnel and Financial Partners Channel staff. We reviewed CSAC's cost allocation plans for fiscal years 1999 and 2000 for reasonableness and compliance with Office of Management and Budget Circular A-87.

To evaluate compliance with the HEA and Federal regulations governing the establishment of the Federal and Operating Funds, we reviewed CSAC's procedures used to set up the funds. We confirmed CSAC's general ledger trial balance at September 30, 1998. We reviewed CSAC's worksheets and related documentation for determining the reserve fund balance of $233,983,566 as of September 30, 1998. To meet our audit objective, we used an alternative methodology to confirm that the reserve fund balance was transferred since we were unable to identify from CSAC records the transfers to the Federal Fund that comprised the reserve fund balance at September 30, 1998. Instead, we calculated the Federal Fund balance as of June 30, 1999 using CSAC-provided revenue and expenditure schedules and compared the calculated balance to the Federal Fund balance shown in CSAC's audited financial statements for June 30, 1999. Based on the comparison, we concluded that CSAC had transferred the $233,983,566 to the Federal Fund.

To evaluate the sources and uses of the Federal Fund and Operating Fund, we analyzed transactions recorded for the State Guaranteed Loan Reserve Fund (reserve funds), the Federal Student Loan Reserve Fund (Federal Fund) , and the Student Loan Operating Fund (Operating Fund). We compared transactions recorded in various months from July 1998 through June 2000 to identify unusual transactions. We traced expenditures to supporting documentation for 27 transactions that were judgmentally selected based on our trend analyses. We performed trend analyses to identify large or unusual transactions within expenditure categories and between time periods.

To confirm that CSAC had identified all nonliquid Federal Fund assets, we reviewed CSAC's schedule of nonliquid assets, audited financial statements, trial balance of general ledger accounts, and building leases. We reviewed correspondence between FSA and CSAC regarding CSAC's proposal to purchase nonliquid Federal Fund assets.

In its program review report, dated October 22, 2001, FSA's Financial Partners Channel reported that CSAC had not deposited collections on FFELs into the Federal Fund within the required 48-hour period. To confirm that CSAC took corrective action, we reviewed the transfers of the Federal share of collections from EDFUND to the Federal Fund for February 2002.

To achieve our audit objective, we relied on standard reports from EDFUND's Financial Aid Processing System. We also used standard reports and electronic data from the State Controller's Office, State Treasury, and CALSTARs (California State Accounting and Reporting System). Our assessment of the reliability of the data was limited to confirming the data to supporting documentation for the transactions reviewed in our audit work and obtaining assurances in CSAC's management representation letter of the propriety of the data provided. Based on these tests and assurances, we concluded that the data were sufficiently reliable for use in meeting our objective.

We conducted our fieldwork from February 11, 2002, through October 2, 2002. The fieldwork was primarily performed at CSAC's and EDFUND's offices in Rancho Cordova, California. A pre-exit conference and exit conference were held at CSAC's office in Rancho Cordova on October 2, 2002 and November 1, 2002, respectively. We performed our audit in accordance with generally accepted government auditing standards appropriate to the scope of review described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of our audit, we made an assessment of CSAC's and EDFUND's management control structures, policies, procedures, and practices applicable to CSAC's administration of the FFEL program. The purpose of our assessment was to assess the level of control risk, that is, the risk that material errors, irregularities, or illegal acts may occur. We performed the control risk assessment to assist us in determining the nature, extent, and timing of the substantive tests needed to accomplish our audit objectives.

To make our assessment, we identified significant controls and classified them into the following categories:

- Establishment of the Federal and Operating Funds
- Sources and Uses of the Federal and Operating Funds
- Ownership of fixed assets and usage fees

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in CSAC's procedures used to establish the funds and CSAC's and EDFUND's controls over the sources and uses of the funds. Also, we found that CSAC had not established procedures to pay usage fees on a quarterly basis. We describe the weaknesses in the AUDIT RESULTS and the OTHER MATTERS sections of the report.

ATTACHMENT 1

Additional Equipment and Other Assets Purchased and Paid From Reserve Funds in September 1998

In addition to the purchases listed in Finding No. 2, we identified the following equipment and software from CSAC's fixed asset list that were purchased by EDFUND and paid from the reserve fund in September 1998:

			Purchase Date Shown on Equipment List
Computer	Dell Power Edge	$ 20,138	9/30/1998
Computer	Xerox	24,994	9/30/1998
Copier	Konica 2330	6,924	9/24/1998
Copier	Konica 7040	9,980	9/24/1998
Copier	Konica 7150	15,409	9/24/1998
Copier	Konica 7150	15,409	9/24/1998
Copier	Konica 7033	9,117	9/24/1998
Copier	Konica 7033	9,117	9/24/1998
Copier	Konica 7033	9,117	9/28/1998
Copier	Konica 7033	8,555	9/30/1998
Copier	Konica 7033	12,674	9/30/1998
Printer	IBM Line	10,205	9/30/1998
Printer	IBM Line	10,205	9/30/1998
Printer	Xerox Color	15,958	9/30/1998
Projector	Video DLX 650	7,520	9/30/1998
Server	Digital AS 1000	9,021	9/30/1998
Server	CD600/60X	93,440	9/29/1998
Server Rack	---	14,481	9/30/1998
Software	HP Open Interface	6,569	9/30/1998
Software	Heat	10,770	9/30/1998
Tape Drive	Procom 7000	26,476	9/30/1998
Video Conferencing	Pictel	29,774	9/30/1998
Video Conferencing	Pictel	29,507	9/30/1998
Video Conferencing	Pictel	77,453	9/30/1998
Video Conferencing	Pictel	88,996	9/30/1998

The above amounts may not include maintenance, training, and other service costs, which may have also been paid with reserve funds in September 1998.

ATTACHMENT 2

CSAC Comments on the Draft Report

CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR

March 06, 2003

Gloria Pilotti
Regional Inspector General for Audit
U.S. Department of Education
Office of Inspector General
501 I Street, Suite 9-200
Sacramento, CA 95814

Subject: Response to OIG Draft Audit Report A09-C0013

Dear Ms. Pilotti:

Attached is the California Student Aid Commission's response to the Draft Audit Report issued January 22, 2003. This audit was focused on the Commission's administration of the Federal Family Education Loan Program Federal and Operating Funds.

We would like to thank you for extending the deadline for us to submit our response.

The Commission and EDFUND are dedicated to compliance with HEA provisions and Federal regulations regarding the use of the Operating Funds.

If you have any questions or need further clarification to our responses, please do not hesitate to contact Cheryl Lenz at (916) 526-6474.

Sincerely,

Jacqueline Tsang

Jacqueline Tsang
Chief Deputy Director

C: Becky Stilling/EDFUND
Pat Veloso/EDFUND

MAILING ADDRESS: P.O. Box 419026 STREET ADDRESS: 10834 International Drive Rancho Cordova, CA 95741-9026
TEL 916/526-8999 FAX 916/526-8033 WEB SITE www.csac.ca.gov

OIG Response
ED-OIG/A09-C0013
G. Pilotti
March 6, 2003

FINDING NO. 1 – CSAC Improperly Used It's Reserve Funds for $7.4 Million of Accrued Administrative Expenses

CSAC Response

As noted during the audit process and in preliminary potential finding discussions on this topic, CSAC uses accrual accounting as the basis for maintaining the financial records of the student loan operating fund and the federal fund. This basis has been employed at the instruction of the Department of Education (Department). Although the OIG audit report references section 34 CFR 682.410 where cash basis accounting is discussed for the one fund structure, the Department has provided subsequent instruction requiring accrual accounting and reporting in the context of the current two fund structure.

On August 24th and 25th, 1998, the Department held a guaranty agency training conference in Washington D.C. As part of that training conference the Department clarified the reporting requirements for the monthly 1189 and annual 1130 federal reports. Section F of the annual 1130 was then the financial statement portion of the report (currently called the Form 2000, annual section) where the balance sheet and income statement data was reported for the fiscal year. When asked, as part of that training, how the Department wanted the reserve fund balance to be determined, the training instruction specified that the data on this financial report should equal the amounts on the guaranty agency's general ledger on an accrual basis for the fiscal year being reported. In accordance with that instruction, the September 30, 1998 reserve fund balance was accounted for and reported by CSAC using accrual accounting.

We note that 34 CFR 682.410(a)(3) does allow the Secretary to approve a different accounting basis other than cash. By explicitly directing guaranty agencies to use accrual accounting for the period ending September 30, 1998, the Department was specifically approving a different accounting basis. This was clearly within the Secretary's authority and CSAC complied with that instruction.

Additionally, the Higher Education Amendments of 1998, enacted on October 7, 1998, required each guaranty agency to establish a Federal Fund and an Operating Fund. Regulation 34 CFR 682.419(f)(1) instructs the use of the accrual basis of accounting for the maintenance of these funds. Because the reauthorization act implemented accrual accounting as the official accounting basis, it was clearly logical that the September 30, 1998 year-end report be on this same basis. We note that if CSAC failed to utilize this consistent method of accounting, a reconciliation tracing the transition from a one fund to a two fund structure would be virtually impossible. Accrual accounting is the approved generally accepted accounting principle since it is an accounting basis that more accurately matches revenues and expenses to the accounting period they relate.

Based on the above, CSAC was acting under the specific and appropriate guidance from the Department in its use of accrual accounting and we request this finding be removed from the audit report.

FINDING NO. 2 – CSAC Improperly Used Its Reserve Funds for $4.5 Million of Purchases That Were Used for Administering the FFEL Program After September 30, 1998

CSAC Response
CSAC disagrees that the purchases referenced in this issue were not reasonable or necessary at the time the decision was made. Prior to committing to any of the purchases in question, our technology division spent many research hours investigating which products would best support our needs. With due deliberation and in periods preceding the actual purchases, both the EDFUND Board and CSAC Commission approved the purchases as part of a larger project. In most cases, the procurement process began well before September of 1998 although the purchases concluded at the end of September.

The purchases were consistent with standard business practices and accounting standards as reviewed by our independent accounting firm.

At the time of these purchases, CSAC was in the midst of an accelerated project with Great Lakes Higher Education Guaranty Corporation (the FAST project) to transition to a new system for housing the student loan portfolio data. This project had a very aggressive timeline attributable in part to a mandate by the Department, citing the current system as significantly deficient. Unfortunately, not long after the asset purchases, the joint project with Great Lakes reached an impasse and the relationship was subsequently disbanded. As a result, well after September 1998, CSAC reassessed its development options and then sought and obtained the Department's approval to upgrade the current system to meet the Department's requirements rather than transition to a new system.

Had CSAC known the FAST project would not be completed as planned, the assets would not have been purchased at that time. However, in the period immediately preceding and then in September 1998, CSAC was functioning with the best information available at the time on a project that had an aggressive completion time line and one that was fully authorized and approved. While the OIG may disagree with the business decision that was made, that is not a sufficient basis for disallowing the expenditures. Therefore, we request this finding be removed from the report.

FINDING NO. 3 – CSAC Improperly Used About $1 Million of the Federal Fund for Supplemental Preclaims Assistance Activities

CSAC Response
Section 422A(c)(4) states that, after the establishment of the Federal Fund, all amounts received from the Secretary as payments for supplemental preclaims activity (SPA) must be deposited into the Federal Fund. The SPA process was such that an account was not eligible for SPA payment from the Department until 150 days after the lender requested SPA assistance and the lender did not file for claim payment during that time. Therefore, SPA assistance requested prior to October 1, 1998 could not be paid by the

Department until the required timeframes elapsed and then only on those accounts where lenders had not filed for claim payment.

CSAC outsourced its SPA activity to an external vendor. Vendor payments for SPA work were not made until the account qualified for SPA payment from the Department. Therefore, actual SPA expenses incurred in generating SPA revenues were unknown until the SPA cycle was complete.

The Department recognized the appropriateness of matching the SPA revenue against the expense incurred to produce that revenue identified in 34 CFR 682.410 where both are authorized sources and uses of funds.

Although 34 CFR 682.419 does not specifically address SPA expenses from assignments made prior to October 1, 1998 as an acceptable use of Federal Fund monies, CSAC believes that this was the Department's intent. 34 CFR 682.419(c)(9) authorizes "any other amounts authorized or directed by the Secretary." Matching expenses to the revenues they produce in the fund benefiting by such revenues is consistent with prior SPA treatment by the Department and in accordance with generally accepted accounting principles.

This specific SPA expense treatment was also addressed in an NCHELP "Question and Answer" formally addressed to Pam Moran on December 2, 1998. That question and answer document was developed and submitted for the Department's review and concurrence as part of the Department's reauthorization implementation task force process. Failure to reply on that matter (and others) was interpreted by the reauthorization task force that developed the document as consent of all items discussed. As the Department is well aware, when no response was received offering document changes or disapproval, NCHELP subsequently distributed the question and answer document as guidance for all guaranty agencies to follow.

Additionally, although CSAC did not accrue for either SPA revenues and expenses as of September 30, 1998, and it could have done so based on reasonable estimates of what probably would have been realized from assignments made prior to that date, such estimates would have been acceptable and supportable under accrual accounting. Had SPA revenue and expense estimates been posted to the accounting records, the Federal Fund balance would have the same fund balance impact as is currently reflected. Therefore, we do not believe CSAC improperly used the Federal Fund for SPA activities and we request this finding be removed from the report.

FINDING NO. 4 – CSAC's Procedures Delayed Deposits of Federal Payments Into the Federal Fund

CSAC Response

CSAC is in agreement with this OIG finding and has reimbursed the Federal Fund for the lost interest income. A transfer of cash to the Federal Fund in the amount of $264,141 was completed on January 13, 2003 covering lost interest earnings from December 1998 through September 2002.

New procedures have also been implemented to ensure all deposits to the Federal Fund are processed within one business day of receipt. These procedures were instituted in September of 2002, therefore, no additional interest income was lost subsequent to that date.

FINDING NO. 5 – CSAC Did Not Pay Usage Fees to the Federal Fund

CSAC Response

As noted in this finding, CSAC submitted a proposal to purchase these non-liquid assets to the Department on December 12, 2000. CSAC made a good faith offer of $113,500 for the purchase of these assets in lieu of paying a usage fee and has not yet received a response from the Department concerning this offer. The funds for the purchase of these assets have been deposited in an interest bearing account (which will accrue to the Department's benefit) pending the outcome of the discussions between CSAC and the Department.

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Auditee

Mr. Wally G. Boeck
Executive Director
California Student Aid Commission
10811 International Drive
Rancho Cordova, CA 95741-9026

ED Action Official

Ms. Theresa S. Shaw
Chief Operating Officer
Federal Student Aid

Other ED Officials/Staff (electronic copy)

Audit Liaison Officer
Financial Partners
Federal Student Aid

Correspondence Control
Office of General Counsel

Assistant Secretary
Office of Legislation and
Congressional Affairs

Assistant Secretary
Office of Intergovernmental
and Interagency Affairs

Director
Financial Improvement and
Post Audit Operations
Office of the Chief Financial Officer

Post Audit Group Supervisor
Financial Improvement and
Post Audit Operations
Office of the Chief Financial Officer

Indirect Cost Group Supervisor
Financial Improvement and
Post Audit Operations
Office of the Chief Financial Officer

Press Secretary
Office of Public Affairs

Assistant General Counsel
Office of the General Counsel

Deputy Secretary
Office of the Deputy Secretary

Chief of Staff
Office of the Secretary

Under Secretary
Office of the Under Secretary

Director
Office of Public Affairs

Director, Western Region
Partner Services, Financial Partners
Channel
Federal Student Aid

Other

Mr. Steve Westly
California State Controller
P.O. Box 942850
Sacramento, CA 94250-5872